BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of the Rate Increase Request of	)	
Indian Hills Utility Operating Company, Inc.	)	File No. WR-2017-0259

APPLICATION FOR RECONSIDERATION OR REHEARING

COMES NOW Indian Hills Utility Operating Company, Inc. ("Indian Hills" or the "Company"), and pursuant to §386.500, RSMo., submits its Application for Reconsideration or Rehearing of a *Report and Order* issued by the Commission in the above-captioned matter on February 7, 2018 (hereinafter "Order"). In support hereof, Indian Hills states as follows:

1. The Order of the Missouri Public Service Commission ("Commission") is unlawful, unreasonable, unjust, arbitrary and an abuse of discretion for one or more or all of the reasons hereinafter set forth. For these reasons, the decision of the Commission should be reconsidered or the case should be reheard and the Order in this case should be amended or superseded to address and correct the matters of error raised by the Company.

DEBT COST

2. Among other things, the Order addresses the issues associated with the appropriate cost of capital as a component of the Commission's determination of Indian Hills' revenue requirement. (*See*, pp. 45-66) In this regard, the Commission determined that compliance tariffs should be based on a 50:50 debt to equity ratio with the cost of debt at an imputed 6.75% and a return on common equity at 12%, representing a weighted average cost of capital ("WACC") of 9.375%.[1]

[1] A summary of these findings appears at page 45 of the Order.

3. The justification in the order for using the 6.75% interest rate is grounded in part on the conclusion that the Company's evidence supporting Exhibit 15 was not able to be effectively subjected to cross-examination.[2] This finding is unwarranted in the circumstance because this evidence was provided by the Company to rebut OPC witness Meyers' Schedule GRM-SUR2, which was filed **as part of his surrebuttal testimony**. Not having had an opportunity to respond to Mr. Meyers' schedule in pre-filed testimony, Indian Hills compiled and presented evidence at the hearing in the only way available to it, to distinguish the circumstances of each and every one of the small water companies identified in that schedule from that of Indian Hills. It is, therefore, an abuse of discretion to disregard the Company's evidence on this point simply because Schedule GRM-SUR2 was introduced in the final round of prepared testimony. By disregarding Indian Hills' distinguishing evidence and imputing a cost of debt of only 6.75% based in large part on Schedule GRM-SUR2, the Commission acted arbitrarily and capriciously.

4. This error is consequential. The use of an imputed cost of debt of 6.75%, instead of the Company's actual cost of 14%, to determine its WACC results in rates that are insufficient to cover the Company's contractual debt service obligations, much less provide a return to its equity investors. This can be illustrated thusly:

	WACC	Net Operating Income	Income Available for Common Shareholders	Return on Common Equity
Ordered by the Commission	9.375%	$176,260	($26,740)	-6.22%[3]

[2] *Report and Order*, p. 58.

[3] This tabulation and calculations follow the format, inputs and methodology supporting Table 1 on page 3 of Company witness Dylan W. D'Ascendis' Rebuttal Testimony (Exh. 11).

On its face, the consequence of the Order is to place Indian Hills in the position of defaulting on its contractual debt obligations and to chart a course to insolvency. The Order thus is unlawful in that it represents confiscatory ratemaking in violation of the Fifth and Fourteenth Amendments to the Constitution of the United States and in violation of Article I, §10 of the Constitution of the State of Missouri.

5. Because the end result of the Order does not provide for revenues adequate to service the Company's debt obligations and does not provide for any return whatsoever on equity capital, it is further unlawful and unreasonable in that it does not meet the standard the Commission enunciated in 2010 wherein it found that a "just and reasonable" rate under the law is one that is fair to both the utility and its customers, is no more than sufficient to keep public utility plants in proper repair for effective service to the public, **and insures investors a reasonable return upon the funds invested**.[4] The constitutional standards for determining whether an authorized return is fair and reasonable was established by the United States Supreme Court as follows: (1) Returns must be consistent with other businesses having similar or comparable risks; (2) The return must be adequate to support credit quality and access to capital; and, (3) The end result, regardless of the analytical methods used, must result in just and reasonable rates. *Bluefield Water Works & Improv. Co.*, 262 U.S. 679, 692-93 (1923); *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944). The Order does not meet these criteria.

6. Additionally, the Order mentions, but gives short shrift to, the compelling factual background which has resulted in the much improved operational circumstances under which the Company now operates. The Commission will recall that Indian Hills took over the troubled

[4] *In the matter of Missouri Gas Energy*, Report and Order in Case No. GR-2009-0355 dated February 10, 2010, page 7.

operations of I. H. Utilities, Inc. ("IHU") in 2016.[5] Since that time, the Company has invested substantial capital to upgrade the water system and improve service to its customers. The Commission notes in its Order at page 59 the Company's successful remediation of IHU's environmental violations. The Commission's sharp criticism in the Order of the terms of the Company's debt financing is disconcerting, particularly given the relevant operational and regulatory history.

7. The principal terms of the loan agreement that is so robustly criticized by the Office of the Public Counsel ("OPC") and whose critiques have been sanctioned by the Commission cannot have come as a surprise. In its Application to the Commission in File No. WO-2016-0045, Indian Hills outlined its plans for obtaining capital associated with its takeover and rescue of IHU. In a term sheet filed with the Application on August 25, 2016 (Appendix H HC), the 14% interest rate[6] and the prepayment terms[7] were disclosed. Significant concerns about the cost (for example, the significant difference between a 14% debt rate and a 6.75% debt rate) or other consequences of the Company's financing should have been raised prior to the time the financing was closed. The Order thus is unlawful and unreasonable.

8. Additionally, the Commission's finding in this case that 14% debt is not just and reasonable "as to the customers"[8] and to substitute instead a 6.75% rate appears to conflict with the Commission's findings in the 2016 acquisition case, a circumstance the Order does not directly address. As noted above, the essential terms of the Company's debt financing were made known to the Commission as part of Indian Hills' 2016 Application. Presumably, the

[5] As noted in the Commission's February 3, 2016, order in File No. WO-2016-0045, IHU had been administratively dissolved and even though given notice of, and opportunity to intervene in, that proceeding, it did not participate.

[6] "Fixed Interest Rate: 14%"

[7] "Prepayment: 14% of total interest remaining in loan schedule"

[8] *Report and Order,* pp. 55-56.

Commission carried out its duty to consider the financing terms associated with the acquisition of IHU in its File No. WO-2016-0045, as part of its review of the filing. It is, therefore, proper to infer that the Commission had determined that the transaction's financing terms were reasonable (or not grossly unreasonable); a necessary element in deciding whether the transaction was detrimental to the public interest.

9. The Commission's concern about the cost of debt assumed by Indian Hills is understandable as an abstract matter and, were there any evidence that lower cost debt actually was available to it in 2016, the Commission's adjustment might be justified, but the fact is that the Company provided competent expert and other testimony that lower cost debt capital simply was not available for it to finance the takeover and rescue of IHU. The Commission's disregard of this testimony in favor of OPC's conjecture that lower cost debt was available because another much larger company has financed with debt bearing an interest rate equal to 6.75% is unreasonable, arbitrary and capricious in nature.

10. As a part of this decision, the Commission muddles and confuses the relative burdens of the parties[9] and, thus, creates a significant error in the Commission's findings. While the Company had the ultimate burden of proof (or persuasion), the burden of producing evidence shifts to the party asserting the contrary of the matter once the moving party presents a *prima facie* case.[10] Thus, Indian Hills met its burden of coming forward with evidence by presenting the testimony of Josiah Cox, the Company's President, and Michael Thaman, an expert in business finance, to the effect that no lower-cost debt capital was available *to the Company* at the time of the acquisition. At that point, the burden of going forward with the evidence to prove that lower cost debt capital *was* available to Indian Hills at the time of the acquisition shifted to

[9] *See*, *Report and Order*, p. 60.

[10] The Commission applied this evidentiary rule in its August 5, 2004, Order Closing Case in its File No. GO-2003-0354 at page 3.

the OPC, the party making that assertion. That burden was not met merely by pointing out that some *other* dissimilar company in some *other* jurisdiction at some *other* time was able to obtain debt capital on more favorable terms.

11. Ultimately, the Order does not generate just and reasonable rates for failure to provide for bilateral fairness. *State ex rel. Valley Sewage Co. v. Public Serv. Comm.*, 515 S.W.2d 845, 850 (1974). The Commission asserts that the Company's customers have not been benefitted by the debt financing terms, but the Commission found that customers of Indian Hills *have* benefitted from having a troubled water supply system taken over and have seen substantial improvements made to the water system's plant and operations by virtue of capital investments made available by its new owners. In disregard of this finding, the rates approved by the Commission not only fail to generate the revenue needed to service the Company's debt, but fail to provide any return whatsoever to its equity investors.

12. Lastly, although the Order concedes that parties are free to establish the terms and conditions under which credit is extended to a borrower, it contains certain ambiguous language with regard to the loan agreement's prepayment penalty language. Specifically, the Commission directs that "the tariffs shall include in rates and charges no amount for a prepayment penalty."[11] There is no evidence in the record that the Company has sought to refund its indebtedness, or that the prepayment penalty clause has been triggered and that any monies with respect to it are currently due and owing. Necessarily derivative of this fact is that Indian Hills has not sought to recover in rates any amounts associated with this aspect of the loan agreement in this case. Where the prepayment penalty is concerned, there is no impact for rates and charges purposes. In this light, the Company views the quoted language in the Order as has having no practical consequence at the time compliance tariffs are filed. However, to the extent the language in the

[11] Report and Order, p. 62.

Order is intended to negate or modify a term of the loan agreement, the Commission may not do so. It has no statutory authority to enforce, construe or annul contracts because it is not a court of law and any attempt to do so is unlawful and unreasonable. *Wilshire Constr. Co. v. Union Electric Co*., 463 S.W.2d 903, 905 (Mo. 1971); *May Dept. Stores v. Union Electric Co*., 107 S.W.2d 41, 49 (Mo. 1937).

RATE CASE EXPENSE

13. The Order's determination that rate case expense should be capped at $5,722 is unreasonable in that it is not based on competent and substantial evidence. This figure, drawn from a November 22, 2017, Non-Unanimous Stipulation and Agreement ("Stipulation") that was filed in the case, but not approved by the Commission, is based on rate case expenses incurred as of an early point in the case and does not include rate case expenses associated with preparation for the evidentiary hearing, participation in the evidentiary hearing, and preparation of the Company's Brief. The amount identified by the Order has no record support and is, therefore, not competent evidence in the case. To the contrary, the Stipulation includes language agreed to by the signatories that it is an integrated whole and, unless adopted in total by the Commission, is "void" and neither signatory will be bound by any of its terms.[12]

14. Staff's brief addresses rate case expense on pages 16 and 17 and states "[i]f the Stipulation is approved, this number [$5,722] is frozen, and there will be no true-up to increase rate case expense incurred in this case due to the hearing. If the Stipulation is not approved, Indian Hills will be able to submit a higher, final rate case expense number to be included in cost of service."

15. Consistent with this, the Company took the position in its post-hearing brief (and still maintains) that its rate case expense should be "brought forward to a cut-off date at least one

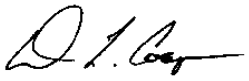
[12] *See, ¶15.*

week after the filing of the post-hearing brief (and normalized over three years)".[13] The Order should be corrected to include an appropriate level of rate case expense.

Conclusion

For the reasons stated herein, Indian Hills respectfully requests that the Commission reconsider its Order or, alternatively, grant the Company's Application for Rehearing, and upon rehearing, issue a superseding or correction order directing that compliance tariffs be filed based on a cost of capital derived using the contractual interest cost of 14%, rate case expense through at least January 11, 2018, and making such other findings as are consistent with the matters set forth above.

Respectfully submitted,



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[13] Company Brief, p. 27.

CERTIFICATE OF SERVICE

I hereby certify that copies of the foregoing have been transmitted by electronic mail to the following on this 16th day of February, 2018:

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